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## THE FINANCIAL PROBLEMS OF PORTO RICO.

The financial problem that confronted the civil administration of Porto Rico upon its inauguration in May, 1900, was very much graver than the simple task of raising enough money to meet current expenses. It involved not only the reform of Spanish methods of administration, but the reconstruction of the existing system of taxation, and the latter problem, grave enough in itself, was complicated by certain social conditions largely engendered by centuries of Spanish control, but magnified by the effects of the change of sovereignty and the hurricane of August 8, 1899.

The fiscal system which the American army found in force upon their occupation of the island in October, 1898, had been, in appearance at least, a successful system. But few of the towns had been allowed to borrow, and none excessively; the insular government had no debt, and on several occasions had loaned money to the Spanish treasury; the taxes aroused no violent opposition, and were collected practically up to the last dollar.

The Spanish system of taxation comprehended a tariff of customs duties, plus tonnage duties, a transitory tax of 10 per cent, and additional imposts on the loading and unloading of freight and the embarkation and disembarkation of passengers, an insular *consumo* tax on petroleum, ecclesiastical bulls, real dues upon the inheritance and transfer of property, and taxes upon wills, bills of lading, notarial documents and instruments of indebtedness, all paid by means of stamps or stamped paper. These were the principal indirect taxes. There were in addition a passport or poll tax, a direct tax upon the income from agricultural and urban property, and a cumbersome system of license taxation called the industrial and commercial tax which was paid by corporations, professional and salaried men, as well as by merchants and manufacturers.

Such, in brief, was the Spanish system of taxation. Its efficiency was superficial. It aroused no opposition, because the direct taxes were largely evaded through the complexity of the law and the venality of the officials, while the greater burden of the indirect taxes was shifted from those who owned property and were able to protest effectively, upon a sodden, inarticulate peon class which was too ignorant either to protest or to realize the economic causes of its own degradation. The direct taxes were collected efficiently, but their collection was farmed out and the delinquent taxpayer was brought to book by an administrative process that was mercilessly effective when unimpeded by bribery. It supplied the needs of the State, because the government lacked almost all the functions which distinguish the modern from the medieval state. There were government officials by the hundred, but transportation was by pack-horse; there was a state church supported by taxes which, during the last decade of the preceding century, averaged nearly \$200,000 a year, but there were practically no public schools; there were courts of law, policemen in the cities, and a civil registry system, but the state conducted a lottery, gambling was unrestricted, petty thieving was, and still is, universal, and one-fourth of the children were born out of wedlock.

The activity of the military government was, of necessity, chiefly destructive. It is true that a new poll-tax was levied by the military government, although it was never collected, and excise or higher license taxes authorized on the sale of alcoholics, tobacco, matches, playing cards and oleomargarine, which failed to fulfill the purpose for which they were created, the supply of adequate municipal revenues. But, in general, the financial activity of the military government was very properly confined to the abolition of abuses in the Spanish law or administration. Ten days after the American occupation, the use of documentary stamps and stamp paper was abolished, and a month later the real dues on the inheritance and conveyance of property were annulled.

Following this came a gradual abolition of the *octrois* or *consumo* taxes, which the municipalities had been permitted to levy upon all articles of food, fuel and drink; until by general orders of April 24, 1900, practically all *consumo* taxes were removed save those on liquor and tobacco. In January, 1899, the rate of the territorial tax was reduced and the method of assessment simplified. In February the foreclosure of mortgages was suspended, and in the fall of the same year, following the hurricane, the collection of taxes was suspended.

The result of these measures has been to increase immeasurably the difficulties of the civil government with respect to financial administration. The suspension of tax collections resulted eventually in the accumulation in the treasury department of over ten thousand<sup>1</sup> "expedientes" or appeals for the remission of taxes, pending whose investigation and decision the taxes in question could not be collected. And the hurricane was doubly disastrous. In itself it was, as Mr. Carroll, the Special Commissioner of the United States, said, "terribly destructive." Its indirect result was a flood of hasty alms-giving that prevented a great amount of suffering but stimulated fraud and produced a certain pauperization of the lower classes.

Taken all in all the events and measures of the military government, together with the sentimental attitude of public opinion in the United States towards Porto Rico, fostered in the people a disinclination to pay the price of self-government, and a vague hope that, through borrowing or by the bounty of the United States, the burden of taxation would be indefinitely postponed. This condition is due to no fault of the military government; it is one of the inevitable results of the change of sovereignty through the intermediate stage of a military government. Our school histories speak glibly of the industrial disorganization attendant upon the change of government in the south after the civil war, but without

<sup>1</sup> The total number of tax-payers is only 40,000.

personal contact it is difficult to realize the intensity of the industrial timidity it creates and the hope it arouses in the minds of tax-payer and other public debtors that in the mêlée of reconstruction they will be enabled to escape their obligations to the state.

To replace a preponderantly indirect by a preponderantly direct system of taxation; to abandon the *consumo* tax and secure larger revenues from sumptuary taxation upon alcoholics, tobacco and matches—matches being practically a supplementary commodity to tobacco in Porto Rico; to abolish the industrial and commercial tax which had been framed by the Spanish merchants, as they say in Porto Rico, "to push and pull with," to push your competitor out of business and to be pulled down as low as was convenient for your own pocket; to resist paternalistic schemes of relief; to teach the people that self-government means self-support, and to inject more vigor and common honesty into the administration in the interior of the island; these were the larger financial problems of the civil government upon its inauguration in May, 1900.

Thorough reform could not be attempted until the meeting of the Legislative Assembly in December. But in the intervening seven months marked administrative improvements were made.<sup>1</sup>

One of the most far-reaching changes was in the personnel of the treasury department. Conditions were particularly bad in the interior of the island, but the reform began in the office of the treasurer itself. During the Spanish régime the appointing power had been used to build up or retain a political following, and in order to make the following as large as possible, offices had been multiplied and salaries reduced until few clerks had either enough to do or enough salary

<sup>1</sup> The financial administration of Porto Rico is vested almost completely in the offices of the auditor and treasurer, the influence of these officers being greatly increased by the close connection between legislation and administration under the civil government, and by the fact that the auditor is a member, and the treasurer the chairman, of the finance committee of the executive council.

to yield them an honest living. Not only was the morale of the office low, but the work and responsibility were so distributed that it was almost impossible to bring an error or offence home to any particular individual. This system was promptly abolished. About half the men were discharged and their pay divided among those who were retained. The work was then divided in such a way that it automatically reaches a particular individual who is held responsible for its proper performance.

The trouble in the interior arose from the venality of the tax gatherers and from the fact that the assessment of direct taxes, both for insular and municipal purposes, was made by nearly two hundred separate boards appointed by the sixty odd municipal councils. The insular treasury under the Spanish régime had, of course, possessed the power of inspection and central revision of assessment. But both inspection and revision had been usually conducted by a courteous interchange of sonorous letters. The civil treasurer reached the root of the difficulty by using the telegraph and by appointing a corps of tax examiners and internal revenue inspectors. The result of their work is briefly described in the interesting report of the treasurer on the "Operations of the Office of the Treasurer, from May 1, 1900, to October 31, 1900:" "In the course of the attendant examination, irregularities, of a more or less long standing, were brought to light in the case of four deputy collectors, and prompt measures taken for the dismissal and punishment of the offenders, this taking the form, in one instance, of the extradition from France and criminal indictment of a fugitive official. Some three hundred cases of fraud against the excise tax on liquors and matches have been detected and referred, through the attorney general, to the district courts for prosecution, resulting, in the large majority of cases, in the conviction of the defrauders. Fines to the extent of over four thousand dollars have already been collected from these delinquents, and the sale

of internal revenue stamps has greatly augmented. Over four hundred cases of fraud on the industrial and commercial tax have also been reported and, in all these cases, the taxpayers have been made to properly assess their industries in the rolls and, in exceptional cases, where merchants were proved to be wilful violators of the law, the penalties and surcharges authorized by law have been imposed."

The effect of these measures is clearly seen in the quarterly collections, taxes being payable quarterly under the Spanish laws. In the quarter ending June 30, 1900, the collection of insular taxes, excluding customs receipts, amounted to \$107,650.16; in the quarter ending September 30, 1900, to \$132,113.63; and in the quarter ending December 31, 1900, to \$136,170.51. The collections in December, the last month of the last quarter, were the greatest of any month since the American occupation.

The brief session of the legislative assembly has now ended, and although only a few laws were enacted—thirty-six in all—most of them were of fundamental importance, and, if time prove that the subjects treated were wisely treated, the session will go down as one of the most memorable in Porto Rican history. Probably the most important, certainly the most widely discussed, act of the legislative assembly, was the passage of a comprehensive revenue bill, which marks the first step in the solution of the financial problems of Porto Rico, and which will, in all probability, constitute the foundation of the future financial system of the island.

This measure—known in Porto Rico as the Hollander Bill—specifically abolishes the old direct taxes only in so far as they were payable to the insular treasury, but it tacitly assumes the reconstruction of the system of municipal taxation and, in fact, takes the initial step in this reform by abolishing all *consumo* taxes and by providing that the tax rolls shall now be prepared, revived and preserved in the insular treasury and not by the sixty odd municipalities.

The principal features of the act are a property tax, an inheritance tax, and excise taxes on various articles.

The property tax replaces what, under the Spanish régime, had been virtually an income tax. This step was taken after long consideration, in virtue of the agricultural character of the island and in obedience to specific provisions of the Foraker Act. The tax itself is not essentially different from the familiar property tax of the States. The ordinary exemptions of churches, schools, working-tools, etc., have been made; the whole assessment will be in charge of a supervisor of assessment, who will be appointed by the governor and who, in turn, will appoint the division and district assessors; the collection of insular taxes will be in the hands of separate collectors, while the sale of property for delinquent taxes will be by the purely administrative process of the Spanish law, modified, however, by the privilege of redemption within three months after the sale; both the municipal and insular rates are limited to one-half of one per cent.

The inheritance tax is progressive, but, unlike most taxes of this kind, varies in accordance with the relationship of the heir and the value of each particular inheritance or bequest, while the commissions of administrators, here as in most other places usually excessive, are taxed as inheritances. The first two hundred dollars in value of every inheritance, and all the property passing to the wife, child, adopted child or grandchild of the decedent, are exempt; from \$200 to \$5,000, the rate is 1 per cent for husbands and lineal descendants, and 3 per cent for other heirs; from \$5,000 to \$20,000, the rate is 1½ per cent for husbands and lineal descendants, and 4½ per cent for other heirs; upon the next \$30,000, 2 per cent and 6 per cent, respectively; and upon the value in excess of \$50,000, 3 per cent and 9 per cent, respectively.

The most interesting feature of the new revenue act is the system of excise taxes upon proprietary medicines, playing-cards, firearms, oleomargarine, matches, alcoholic liquors,

and tobaccos of all kinds. Speaking generally, the rates of the excise taxes are about one-half of those imposed in the United States. The operation of the taxes will also be radically different. In the United States, the stamp is placed upon the package of sale at the time of manufacture, while the most thorough surveillance is maintained both of the sale and manufacture. In Porto Rico, the stamp will be placed on the bill of sale or lading which accompanies the shipment of goods from the factory, while the inspection will be confined almost wholly to the manufacturer and wholesale merchant. These changes were necessitated by the fact that the manufacturer of rum and tobacco, although relatively much more important industries than those of the United States, could not bear the same rates of taxation, while it has been repeatedly demonstrated that the manufacturers are unable to pay the taxes upon their stocks of finished products until they are sold, the purchaser, at present, almost always forwarding the stamps required on the goods which he purchases. At the same time, the device of placing the stamps on the retail packages is a failure in Porto Rico. The patient peon is too economical to tear the stamp upon his box of cigarettes or matches. He sets himself in the sun and soaks the stamp off, washes it, and uses it to buy more cigarettes or matches. And it is impossible to root out the practice by any reasonable amount of surveillance because of the mountainous character of the country, the cost of transportation, the lack of police and the universality of the practice. On several occasions, cigarettes have been found with ten-cent stamps upon packages which sold for one cent.

Under the present system each manufacturer will be furnished with a stub sales-book,<sup>1</sup> on the page and stub of which he will be required to describe each shipment which leaves his factory. The stamps will then be pasted over the per-

<sup>1</sup> Strictly speaking, the tax will be upon the shipment rather than upon the sale of the goods.

forated line which separates the stub and the bill, in such a way that when the bill is detached part of each stamp will be left upon the stub and part upon the bill. Manufacturers will be required to return the stubs to the treasury, and merchants the bills, at regular intervals, so that in this way a reliable check can be kept upon the goods manufactured and sold in the island; while a perfect check can be kept upon imports and exports by means of the customs officers and the applications for rebates allowed upon exports.

The revenue bill was passed unanimously in the upper legislative house, and with but one dissenting vote in the lower house. But it has been subjected to an immense amount of criticism, and a meeting attended by many of the largest property-holders of the island, held after the bill had become a law, sent a delegation to Washington to petition Congress against its enforcement.

Time will prove whether a mistake has been made in subjecting property to a maximum tax of one per cent for both insular and local purposes, or whether this protest is a merely selfish outcry against the shifting of the centre of gravity of taxation from a class of consumers, who as a class are wretchedly poor, upon a class of property owners, who as a class are well able to pay. Two facts, however, are incontestable: the one, that the rich Spanish merchants are with the opposition, almost to a man; the other, that during the Spanish régime, this class evaded their lawful taxes with a success that put the American tax-dodger to shame.

The passage of the revenue bill marks only the first stage in the solution of the real financial problem of Porto Rico. The nature of that problem is well illustrated by a bill, passed by the house of delegates with the approval of practically the whole native population, which directed the insular government to secure and guarantee loans to the farmers and planters of the island, to the amount of \$3,000,000.00.

The justification of such a scheme depends largely upon whether the present agricultural depression is due to tem-

porary conditions, and hence curable by an extraordinary remedy, or to deep-rooted social habits which will only be eradicated by generations of change and improved industrial education. When questioned upon this specific point, the defendant of the loan answers promptly that the present condition is the result of the hurricane and the industrial disturbances attendant upon the change of government. Questioned in another connection, however, he is quite willing to admit that before the Spanish war agricultural conditions were substantially similar to those prevalent in the southern states previous to the birth of the new south; that the planters were in the hands of the money-lenders, improvident and unprogressive, ready to borrow at exorbitant rates, but seldom ready to pay when the debt matured.<sup>1</sup> Public loans at 7 per cent would be spent as the old private loans at 15 per cent, and leave as little permanent effect.

As was to be expected, the bill was defeated by the American members of the finance committee of the executive council. But it sums up admirably the greater financial problems of Porto Rico: the agricultural depression, the desire to postpone the inevitable liquidation of indebtedness, the willingness of the people to subsidize a branch of industry which private credit is afraid to assist, the eagerness for new capital instead of new entrepreneurs, for new wine, but in the old bottles.

T. S. ADAMS.

*San Juan, Porto Rico.*

<sup>1</sup> The testimony upon this point is unanimous: see speech of Mr. Crosas in the "Journal of Executive Council of Porto Rico," January 31, 1901, and the testimony of General Davis in the "Hearing before the Committee on Pacific Islands and Puerto Rico," page 37. Both of these gentlemen are defendants of an agricultural loan.